United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-6045 74-3417

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

B

P/S

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

vs.

RALPH T. IANNELLI, HOWARD FROST, JOHN SURGENT,

Defendants,

JOHN SURGENT,

Defendant-Appellant.

BRIEF FOR DEFENDANT-APPELLANT

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Brief of Defendant-Appellant, John Surgent

STATEMENT OF THE CASE

This action for injunctive relief was commenced by the Securities and Exchange Commission (SEC) on August 6, 1974 pursuant to 15 U.S.C. §§77t(b) and 78u (e). Jurisdiction is predicated upon 15 U.S.C. §§77v(a) and 78aa. The complaint alleges violations of the anti-fraud provisions of the Securities Law against three defendants, Ralph Iannelli (Iannelli), Howard Frost (Frost) and John Surgent (Surgent), as an aider and abettor. The SEC predicates liability of defendant, Surgent, on the theory that he aided the principal defendants, Iannelli and Frost, in the manipulation of the market price of the common stock of Omni-Rx Health Systems, Inc.

On August 14, 1974 defendants, Iannelli and Frost, consented to the entry of permanent injunctive orders against them.

On August 9, 1974, the SEC filed a motion before this Court seeking a preliminary injunction against the defendant, Surgent, as an aider and abettor. Oral argument on the motion was heard on October 7, 1974 at which time the Court ordered a hearing to determine the factual contentions of the parties. This hearing took place on October 23, 1974. At this hearing the SEC moved to consolidate its application for preliminary injunction with that of request for permanent restraints. John W. Surgent consenting to the application, the Court granted that motion.

The essential facts involved herein are as follows.

The defendant, Iannelli, a sales representative in the brokerage firm of Pressman, Frolich and Frost, effected a series of transactions in the common stock of Omni-Rx Health Systems, Inc. by purchasing, without authorization, 95,000 shares of such stock on behalf of 25 customers. These unauthorized transactions were made at a time when the defendant, Iannelli, knew that no payment would be made for these securities. He effected these transactions in order to create the appearance of active trading in the stock and did, thereby, cause a rise in the price of these shares from $2.00 in May to approximately $6.00 per share on September 7, 1973 to $12.00 per share on October 2, 1973. Iannelli hoped that this increase would cause the customer to ratify the unauthorized transactions and induce others to trade in the shares. All of Iannelli's activities were supervised by the defendant, Frost, a broker-dealer, and "market maker" in the Pressman, Frolich and Frost firm, a member of the New York Stock Exchange and other exchanges. Frost, with knowledge of these transactions, failed to take steps to prevent them and, in fact, participated in their commission.

John Surgent is alleged to have assisted in the fraudulent activities of Frost and Iannelli by adopting some of the unauthorized transactions at a time when he knew or should have known that his actions were aiding and abetting their manipulative scheme. The SEC predicates Surgent's knowledge, actual or implied, primarily on the alleged facts that 1) the stock he purchased was offered at a price below the prevailing market price, 2) that Surgent agreed to adopt these transactions, 3) that Surgent dictated letters to Iannelli confirming these transactions and attributing the inconsistent dates of the original trading and his adoption of them to a "computer error;" and, 4) that during the relevant time of these transactions Surgent was aware of the term "wooden tickets," [1] used and heard the term used with respect to his purchases. The SEC claims that Surgent's adoption of these transactions came at a critical juncture in the life of the scheme and substantially assisted its furtherance.

The defendant, Surgent has denied the allegation of the SEC that he was a knowing aider and abettor. Surgent asserts that he was a customer of a New York Stock Exchange firm and was duped by Iannelli out of his original investment and has sustained other losses.

1. The term "wooden tickets" is used to signify unauthorized transactions.

ARGUMENT

POINT I

The evidence is not sufficient to sustain the finding of the Trial Court that Defendant-Appellant, John Surgent, aided and abetted the wrongdoing of others of the Defendants herein.

The Securities and Exchange Commission has sought to enjoin defendant-appellant, Surgent, from future violations of the applicable statutes on the grounds that he aided and abetted the wrongdoing of others of the defendants herein. Section 20 (b) of the Securities Act of 1933 (15 U.S.C. §77t[b], and §21[e] of the Securities Act of 1934 (15 U.S.C. §78u[e]) provide that "whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the act or of any rule or regulation thereunder, it may apply to the District Court to enjoin such acts or practices" and "upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond."

It is Hornbook law that in order to justify the issuance of injunctive relief in the situation anticipated by the cited statutes the Securities and Exchange Commission bears the burden of demonstrating that the target of the injunctive relief has violated the securities laws and that such conduct indicates a reasonable likelihood that there will be further violation in the future. See *Securities and Exchange Commission v. Bennet & Co.*, 207 F. Supp. 919 (D.C. N.J. 1962).

Where the Commission seeks to enjoin a person on a theory of aiding and abetting securities violations, the Commission must show that "the accused party has general

awareness that his role was part of an overall activity that is improper and *** the accused aider and abettor knowingly and substantially assisted the violation." *Securities and Exchange Commission v. Caffey,* 493 F.2d 1304 (7th Cir. 1974); see *Nye Nissen v. United States,* 336 U.S. 613 (1949); citing *United States v. Peoni,* 100 F.2d 401 (2d Cir. 1938); *Securities and Exchange Commission v. Advance Growth Capital Corp.,* 470 F.2d 40 (7th Cir. 1970); *Iroquois Industries, Inc. v. Syracuse China Corp.,* 417 F.2d 963, 970 (2d Cir. 1969), *cert. denied,* 399 U.S. 909 (1970); *Securities and Exchange Commission v. National Bankers Life Insurance Co.,* 324 F. Supp. 189, 195 (N.D. Tex.), *aff'd* 448 F.2d 652 (5th Cir. 1971); *Brennan v. Midwestern United Life Ins. Co.,* 259 F. Supp. 673 (N.D. Ind. 1966), 286 F. Supp. 702, 708 (N.D. Ind. 1968), *aff'd.* 417 F.2d 147 (7th Cir. 1969).

The Trial Court specifically found that defendant-appellant, Surgent, "knew, or should have known what Iannelli had done and that he, by his actions, was assisting Iannelli in concealing the unauthorized purchases and effectuating Iannelli's scheme," citing *Securities and Exchange Commission v. Spectrum Ltd.,* 489 F.2d 535 (2nd Cir. 1973).

Although the Trial Court refers to several facts and circumstances which it contends supports its conclusion of Surgent's actual or constructive knowledge, that conclusion flies in the face of testimony given by both the active wrongdoer, Ralph Iannelli, and defendant, John Surgent. Iannelli readily conceded that he never told Surgent that the trades in issue had originally been unauthorized purchases. And Surgent testified that Iannelli had, in fact, advised him that the shares were available at below the market price because various of Iannelli's customers had not paid for shares.

The record at trial is clear that at no point did Iannelli ever advise Surgent, or even infer, that the trades which Surgent was taking over were unauthorized trades. The following exchange occurred in Iannelli's Cross-Examination:

"Q Didn't you tell Mr. Surgent that he could make a profit on the securities and if he would pay for them, you were tired of Mr. Frost reaping the benefits of the lost trades?

A I told Mr. Surgent stock was available underneath the present market price and that if he didn't purchase it, someone else would, and if another account didn't buy it it would go to the firm's account, and, naturally, they would have the beneficial interest in any depressed stock.

Q In other words, if Mr. Surgent didn't buy the stock the stock would have been sold, either would have been sold to somebody else or the stock would have been liquidated by the account, is that correct, by the firm?

A Or the firm would assume the stock, yes."

At another point in Iannelli's Cross-Examination, the following exchange occurred:

"Q At any time prior to September 26 until this particular date, had you personally ever told Mr. Surgent that these were unauthorized trades that he was buying?

A No. I never had stated to Mr. Surgent, nor had he asked me up to October 1 as to the derivation of the origin of these transactions. I made him cognizant via confirmations, written—computerized confirmations from Loeb Rhoades.

Q But you never overtly came to Mr. Surgent and said, 'But these securities. These people never ordered the

stock, and you can take over the trade and make money on it.' You never said that to him, isn't that true?

A As I stated, I never said that to him and he never inquired as to the origin of the confirmation."

In the course of defendant-appellant Surgent's direct examination he provided the following testimony:

"A Well, he mentioned to me that certain individuals had not paid for their securities and that I could purchase the stock and make a profit on it.

Q Did he tell you how many individuals had not paid for their purchases?

A No, he had not.

Q Did you ask?

A I didn't inquire, no.

Q Was it similar situation with respect to all the shares purchased by Surgent & Surgent, London and Premium?

A I believe the representations were made that there was a certain amount of stocks that were unpaid for by customers, that if I would give him New York Stock Exchange business that he would allow me to pick up the trades if I would pay for them and make a profit on them.

Q Thank you.

A That's exactly what he said."

In light of the state of the record, and especially in light of the testimony set forth at length above, it is submitted that the record does not demonstrate that Surgent actually knew of the unauthorized nature of the Omni-Rx transactions adopted by him. It is further submitted that given Iannelli's and Surgent's testimony stated above, the other evidentiary matters relied upon by the Trial Court do not support the conclusion that even if he did not have

actual knowledge Surgent had constructive knowledge of the unauthorized nature of these trades.

POINT II

The evidence is not sufficient to support the issuance of an injunction herein.

Even assuming that the evidence is sufficient to sustain the conclusion of the Trial Court that defendant-appellant, Surgent, aided and abetted the scheme of Iannelli, it is respectfully submitted that the case does not present a situation warranting the granting of injunctive relief. Obviously, the Court may grant injunctive relief upon an appropriate showing by plaintiff Commission. See *SEC v. Manor Nursing Center, Inc.*, 340 F. Supp. 913 (S.D. N.Y. 1971). The elements required to be established to warrant the granting of injunction for securities violations are identical to those traditionally present in equity actions seeking injunctive relief. *SEC v. Frank*, 388 F.2d 486, 491 (2d Cir. 1968).

The test is whether the defendant's past conduct indicates, under all of the circumstances presented, that there is a reasonable likelihood of further violations by the defendant in the future. *Goshen Mfg. Co. v. Herbert H. Myers, Mfg. Co.*, 242 U.S. 202, 37 S. Ct. 105, 61 L. Ed. 248 (1916); *SEC v. Culpepper*, 270 F.2d 241, 249-250 (2d Cir. 1959). Included in the circumstances which a Trial Court must consider in determining the appropriateness of injunctive relief are the character of past violations, and the effectiveness of any discontinuance of past conduct violative of statutory prohibitions. *United States v. W. T. Grant Co.*, 345 U.S. 629, 633; 73 S. Ct. 894, 97 L. Ed. 1303 (1953); *SEC v. Culpepper, supra*, at 935.

"The critical question for the District Court in deciding whether to issue a permanent injunction *** is whether

there is a reasonable likelihood that the wrong will be repeated." *SEC v. Manor Nursing Center, Inc.*, 458 F.2d 1082, 1110 (2d Cir. 1972).

As was stated in *Shore v. United States*, 282 Fed. 857, 859 (7th Cir. 1922), "relief by injunction looks towards the future. Its purpose is to prevent future injury. * * * If the transgressions have ceased * * * and if it appears that they will not be repeated, injunctional relief will not be granted." And as was stated in *United States v. W. T. Grant Co., supra*, "the necessary determination is that there exists some cognizable danger of recurrent violation, something more than the mere possibility which serves to keep the case alive."

In the instant case, the defendant is not a person regularly engaged in the securities business thus immediately decreasing the likelihood of his violating statutes regulating that industry. Moreover, although a member of the Bar and engaged in the active practice of law, in the instant situation he was not acting in a representative capacity but as a principal in buying and selling securities.

Plaintiff commission has presented no evidence to suggest that defendant-appellant Surgent has never been involved previously in the violation of any statutes governing the securities industry. His conduct, even assuming that he was aiding and abetting Iannelli's scheme, was not a factor in the initiation nor was it essential to that scheme. No evidence has been adduced, nor has there even been a suggestion, that when Iannelli entered into a scheme of engaging in unauthorized purchases of Omni-Rx stock that the possibility of Surgent taking over these trades was ever conceived.

Certainly in determining the appropriateness of the issuance of injunctive relief under the circumstances pre-

sented, the Court should take into consideration the serious impact of such relief on the defendant when weighed against the improbability of his engaging in conduct violative of the Securities Laws in the future.

The defendant-appellant Surgent is a member of the Bar. As a result of the findings of the Trial Court and the issuance of an injunction, he is subject to serious disciplinary action. The very threat of such disciplinary action, even should the determination of the Trial Court be reversed, would seem to further suggest that there is little likelihood in Surgent's repeating the conduct alleged herein or conduct similar thereto.

Accordingly, in light of defendant's minimal role, at worse, in Iannelli's scheme, the fact that he is not regularly engaged in the securities business, the fact that there has been no evidence of any other violations on his part, the fact that he has been and is a member of the Bar of the States of New Jersey and of West Virginia, it is respectfully submitted that the granting of injunctive relief by the Trial Court should be reversed.

CONCLUSION

For all the foregoing reasons, it is respectfully submitted that the findings and the judgment of the Trial Court should be reversed.

Respectfully submitted,

/s/ Jay D. Fischer
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STATE OF NEW JERSEY)
:ss.
COUNTY OF MIDDLESEX)

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Ronald D. Anzivino

RONALD D. ANZIVINO
NOTARY PUBLIC OF NEW JERSEY
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James B. Rattigan

JAMES B. RATTIGAN